



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	8/16/04	Bill No:	AB 1850
Tax:	Insurance	Author:	Cohn
Related Bills:			

BILL SUMMARY

This bill would require on or before March 1, 2005, the Legislative Analysts Office, in conjunction with the Department of Managed Health Care, the Department of Insurance, the Board of Equalization, and the Franchise Tax Board to prepare a study on the taxation of insurance companies, as specified.

Summary of Amendments

The August 16 amendments removed the provisions providing that a for-profit health care service plan would be considered an insurer solely for the purpose of Section 28 of Article XIII of the California Constitution for its preferred provider organization business, and added provisions requiring the Legislative Analysts Office to prepare a study on the taxation of insurance companies.

ANALYSIS

Current Law

The insurance tax is administered by three state agencies, the Board, the Department of Insurance (DOI) and the Controller. The Controller acts as a collector of the tax. The DOI is primarily responsible for licensing and regulating insurers under the Insurance Code. This includes auditing and recommending any assessment of tax on an insurer. The Board is responsible for issuing the assessments recommended by DOI and for deciding the validity of any petition for redetermination or claim for refund.

Section 28 of Article XIII of the California Constitution provides for the taxation of insurers doing business in California. The basis of the annual insurance tax is gross premiums, less return premiums (commonly referred to as the gross premiums tax). The gross premiums tax is imposed on insurers at a rate of 2.35% in lieu of all other taxes and licenses, with specified exceptions. Generally, any person that meets the definition of an "insurer" pursuant to Section 28 of Article XIII will register with DOI and is subject to the annual gross premiums tax.

The definition of insurer does not expressly include a health care service plan. Health care service plan providers are covered under the Knox-Keene Health Care Service Plan Act. The Department of Managed Health Care (DMHC) is responsible for administration of the Knox-Keene Act. Under the Knox-Keene Act, health care plan providers (including all HMOs and some PPOs) are subject to California's general tax on corporations. Unless otherwise provided by law, corporations doing business or incorporated in California must pay a franchise tax equal to the greater of the minimum

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of \$800 or an amount measured by net income multiplied by the current tax rate, which is 8.84%.

Background

Health plans that operate under the regulations of the DMHC (“managed care” plans that include HMOs and some PPOs) are subject to the Knox-Keene Act which contains an extensive array of consumer protection requirements, minimum benefit packages, and limitations on the amount of co-payments and deductibles. Generally, health care providers such as HMOs and PPOs subject to the Knox-Keene Act provisions under the administration of the DMHC are not subject to the gross premiums tax.

Health insurance that is offered under the DOI’s regulatory structure includes traditional fee-for-service arrangements and some PPOs. In contrast to DMHC-licensed arrangements, however, DOI-licensed plans are subject to different consumer requirements, have a less extensive minimum benefits package, and are allowed to have higher co-payments and deductibles than managed health care plans.

Blue Cross of California is currently the only for-profit PPO registered at DMHC. As such, Blue Cross pays the franchise tax on their PPO business in California rather than paying the gross premiums tax. Even though the tax rate is higher for the franchise tax than it is for the gross premiums tax, it is more advantageous for Blue Cross to pay the franchise tax since it is based on net income as opposed to the gross premiums tax that is based on gross premiums.

Proposed Law

This bill would require on or before March 1, 2005, the Legislative Analysts Office, in conjunction with the Department of Managed Health Care, the Department of Insurance, the Board of Equalization, and the Franchise Tax Board to prepare a study on the taxation of insurance companies that generally pay the gross premiums tax and on health care service plans that generally pay the franchise tax.

The study required by this bill would consider all of the following:

1. Information on the departments that administer these taxes and regulate both insurance and health care service plans.
2. The different tax systems for preferred provider organizations, point of service plans, and any other relevant health care service plans.
3. The economic structure and economic differences between the franchise tax under the corporation tax and the gross premiums tax.
4. The aggregate amount of tax paid by insurers and health care service plans.
5. An explanation of the differences between not-for-profit and for-profit health service plans and not-for-profit and for-profit insurance companies, including the regulatory requirements applicable to each and the difference in the amount of taxes paid by each, and an assessment of the insurance products offered by each.
6. An explanation of the medical loss ratio and its relationship, if any, to taxation.

The study would be delivered to the chairs and vice-chairs of the following committees:

- Assembly Appropriations Committee
- Senate Appropriations Committee
- Assembly Revenue and Taxation Committee
- Senate Revenue and Taxation Committee
- Senate Insurance Committee
- Assembly Health Committee
- Senate Health and Human Services Committee

COMMENTS

1. **Sponsor and purpose.** The measure is sponsored by the author in order to gather additional information and answer specific questions related to the taxation of insurance companies and health care service plans.
2. **Summary of amendments.** As introduced the bill contained provisions that would have placed into law specific requirements related to retention of business records, as defined, necessary for property tax purposes. The **July 28 amendments** removed the property tax provisions and added new provisions related to the definition of insurers for the purpose of imposing the gross premiums tax. The **August 9 amendments** made technical amendments to the bill. The **August 16 amendments** removed the provisions providing that a for-profit health care service plan would be considered an insurer solely for the purpose of Section 28 of Article XIII of the California Constitution for its preferred provider organization business, and added the current provisions.

COST ESTIMATE

Board costs for participation in the study required by this bill are expected to be minor.

REVENUE ESTIMATE

The provisions in this bill would not have any impact on state revenues.

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